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Supreme Court of the United States

OCTOBER TERM, 1934.

No. 374.

ROSS C. ADAMS, Receiver of the Farmers National Bank of Pekin, Illinois, *Petitioner,*

vs.

EDWIN V. CHAMPION, Trustee in Bankruptcy of JOHN FITZGERALD, Bankrupt, *Respondent.*

BRIEF OF PETITIONER.

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(A) Where as in the instant case, and in the companion cases Nos. 338 and 340, set for argument immediately before this case, a claimant seeks to recover from a Receiver of an insolvent National bank money alleged to have been held by the bank on a trust he must affirmatively establish, under the unmistakable trend and weight of Federal decisions: (1) that his transaction with the bank resulted in a trust relationship; (2) that the assets of the bank have been augmented or increased by new cash or property accruing from the claimant; (3) that the new property, in its original or changed form, can be traced to the assets taken over by the Receiver at suspension. No augmentation occurs, hence no tracing exists where the transaction results only in a shifting of bookkeeping credits on the books of the now insolvent National bank. In the instant case the now insolvent National bank received in trust an identifiable res in the form of the four items of collateral, consequently a trust relationship, at the outset, is admitted. The four collateral items were disposed of by the bank prior to its suspension. In exchange for the first three items the bank received nothing but transfers of credit already on its books which did not augment its assets and does not permit trac-

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ing of the proceeds to the Receiver. In exchange for the fourth item the bank received a check on an outside bank, which augmented its assets, but dissipated the proceeds thereof, prior to suspension, except as to the sum of $776.57 (admitted off the record, p. 18 ante). The respondent can establish a trust relationship, augmentation and tracing of funds as to the sum of $776.57 only, which sum should be fixed as the amount of the priority claim rather than the sum of $8,870.07 erroneously fixed by the Circuit Court of Appeals 7

(B) The tracing of funds principle of the Harriett decision, *supra*, relied on by the Circuit Court of Appeals for its allowance of this trust claim in the amount of $8,870.07 is erroneous because in clear conflict with the correct rule established by the weight of authority consisting of the decisions of this Honorable Court and the decisions of many Circuit Courts of Appeal 18 20

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EDWIN V. CHAMPION, Trustee in Bankruptcy of JOHN FITZGERALD, Bankrupt, *Respondent.*

BRIEF OF PETITIONER.

I.

OPINIONS BELOW.

The opinion of the Circuit Court of Appeals for the Seventh Circuit (Sparks, Circuit Judge) is reported in 70 Fed. (2nd) 956 and appears in the record at pages 82 to 87. The opinion of the United States District Court, Southern District of Illinois, Northern Division (Fitzhenry, D. J.) is unreported but its findings of fact, conclusions of law and decree appear in the record at pages 66 to 70.

II.

JURISDICTION.

Writ of certiorari was granted October 22, 1934 (R. 121) under Section 240 (a) of the Judicial Code as amended by the act of February 13, 1925 (U. S. C. Title 28, Section 347).

III.

STATEMENT OF CASE.

The Farmers National Bank of Pekin, Illinois, was found insolvent on January 8, 1932, and placed in the hands of a Receiver, appointed by the Comptroller of the Currency, for liquidation (R. 35). Thereafter, on June 24, 1932, in an action wherein the bank Receiver was not a party, a decree was entered by the District Court of the United States for the Southern District of Illinois Northern Division (R. 27, 30), adjudging that this bank had received an illegal preference from John Fitzgerald, a bankrupt, incident to the bank's receipt, prior to its suspension, of additional collateral for the Fitzgerald indebtedness, and directing the surrender of the collateral to the trustee in bankruptcy, plus payment of cash in lieu of four items of the collateral which were disposed of by the bank prior to its suspension. The bank Receiver complied with the decree by surrendering all of the bankrupt's collateral that passed into his hands (R. 37) but contested that part of the decree requiring the payment of the sum of $8,870.07, representing the value of four items of the bankrupt's collateral disposed of by the bank prior to suspension, on the ground that this claim was general only (R. 38). After a hearing on petition (R. 31 to 38), answer (R. 40 to 43), amendment to answer (R. 44 to 47) and stipulation of all facts (R. 48 to 60), the trial court held (R. 66 to 69) that the bank received the four items in question as trustee; that they were converted into cash by the bank; and by a decree entered July 7, 1933 (R. 69, 70) allowed the bankruptcy trus-

tee a priority claim of $8,870.07 against the bank Receiver. The Appellate Court affirmed the judgment of the District Court, 70 Fed. (2nd) 956 (R. 82 to 87). The bank Receiver's petition for rehearing was denied June 13, 1934 (R. 113).

The record is voluminous and somewhat confusing. *The issue is whether the proceeds of the four items of the bankrupt's collateral, admittedly received by the bank in trust, and disposed of by it prior to suspension, are traceable into the hands of the bank Receiver.* The pertinent record facts are as follows:

ITEM 1. This item consisted of ten shares of the capital stock of this now insolvent National bank, received by the bank as additional collateral for the bankrupt's indebtedness, and sold by it on February 9, 1929, to R. A. Cullinan for the sum of $3,000, *payment being effected by a charge against Mr. Cullinan's credit balance in the now insolvent National bank.* (R. 49-50) A portion of the priority claim allowed by the court below as to this item consisted of a $30 dividend on this stock *representing a debt due the shareholder by the bank.* (R. 49.)

ITEM 2. This item consisted of the Charles Graff note in the total amount of $3,183.78 received by the bank as additional collateral for the bankrupt's indebtedness, *and paid by Mr. Graff on April 12, 1929, by a charge against his deposit balance in this now insolvent National bank.* When Mr. Graff's deposit balance was charged on April 12, 1929, and the note delivered to him, two certificates of deposit, marked "Chas. Graff", representing the proceeds, were issued by the bank to its vice-president Reise whose representative later endorsed the same to the bank receiver. (R. 50 to 53, 61 to 62.)

ITEM 3. This item consisted of the W. C. Sommer note in the total amount of $1,059.98 received by the bank as additional collateral for the bankrupt's indebtedness *and paid by Mr. Sommer on April 16, 1929, by a charge against his deposit balance in the now insolvent National bank.* When

Mr. Sommer's deposit balance was charged on April 16, 1929, and the note delivered to him, two certificates of deposit, marked "W. C. Sommer," representing the proceeds, were issued by the bank to its vice-president Reise whose representative later endorsed the same to the bank receiver. (R. 53, 54, 62, 63.)

ITEM 4. This item consisted of five Veesaert mortgage bonds received by the bank as additional collateral for the bankrupt's indebtedness, and later involved in certain foreclosure proceedings in the course of which the now insolvent National bank surrendered said bonds and received a check in the sum of $1,597.31, drawn on the Edwardsville National Bank & Trust Company, *the proceeds of which passed to the credit of the now insolvent National bank with its correspondent*, the First National Bank of Chicago, on December 13, 1930. (R. 58.) The record, page 58, reflects that the total credit balance of the now insolvent National bank with the First National Bank of Chicago was $643.24 on October 27, 1931, which amount in changed form, is now traceable into the collateral surrendered by the Chicago bank to the Receiver (R. 59, 60). The bank Receiver admits, off the record (p. 18 [illegible]) that the low balance of his bank with the Chicago bank between December 13, 1930, and suspension was $776.57 as of December 28, 1931, which low balance is traceable to the Receiver. The low balance of $643.24 referred to in the record (p. 58) appears to have been erroneously taken from the books of the now insolvent National bank rather than from the books of the Chicago bank.

In answering the action of the bankruptcy trustee to establish a priority claim for the proceeds of these four items, the bank Receiver admitted that a general claim exists but defended against the priority claim on the ground that the bank's assets which passed into his hands were not augmented incident to the disposition thereof by the bank (R. 40 to 47). The District Court held that the four items of collateral were received by the bank in trust, converted

by it into cash, and decreed that payment of the full amount of $8,870.07 be made, subject to the rights of any other priority claimant, out of the sum of $30,548.61, the lowest amount of cash and cash items in the now insolvent National bank from February 5, 1929, to suspension. (R. 66, 69.) The Circuit Court of Appeals held "that the bank's assets were augmented by, and to the extent of the proceeds of the collateral and that those proceeds have, in law, been traced into the Receiver's hands" (R. 87), relying largely upon the tracing of funds rule of Schumacher v. Harriett, 52 Fed. (2nd) 817.

IV.

SPECIFICATION OF ERRORS.

(a) The Circuit Court of Appeals erred in holding, *in view of the record facts,* that any of the proceeds of the four items once held by the bank in trust, have, in law, been traced into the Receiver's hands.

(b) The Circuit Court of Appeals erred in not reversing the trial court's findings that the cash and cash items of the now insolvent National bank were impressed with a trust in any amount in favor of the respondent.

(c) The Circuit Court of Appeals erred in not classifying the respondent's entire claim as general only.

(d) The Circuit Court of Appeals erred in adopting and applying the tracing of funds rule of Schumacher v. Harriett, *supra,* to any of the collateral items because this rule is in conflict with the decisions of this Honorable Court and with the decisions of many Circuit Courts of Appeal.

V.

SUMMARY OF ARGUMENT.

(A) Where, as in the instant case, a claimant seeks to recover from a Receiver of an insolvent National bank money alleged to have been held by the bank on a trust, he must affirmatively establish, under the unmistakable trend

and weight of Federal decisions: (1) that his transaction with the bank resulted in a trust relationship; (2) that the assets of the bank have been augmented or increased by new cash or property accruing from the claimant; (3) that the new property, in its original or changed form, can be traced to the assets taken over by the Receiver at suspension. No augmentation occurs, hence no tracing exists where the transaction results only in a shifting of bookkeeping credits on the books of the now insolvent National bank.

In the instant case the now insolvent National bank received in trust an identifiable res in the form of the four items of collateral, consequently a trust relationship, *at the outset,* is admitted. The four collateral items were disposed of by the bank prior to its suspension. In exchange for the first three items the bank received nothing but transfers of credit already on its books which did not augment its assets and does not permit tracing of the proceeds to the Receiver. In exchange for the fourth item the bank received a check on an outside bank, which augmented its assets, but dissipated the proceeds thereof, prior to suspension, except as to the sum of $643.24 (according to the record). The respondent can establish a trust relationship, augmentation and tracing of funds as to the sum of $776.57 only (based upon the bank receiver's admission off the record (~~ante~~, p. 18), which sum should be fixed as the amount of the priority claim rather than the sum of $8,870.07 erroneously fixed by the Circuit Court of Appeals.

(B) The tracing of funds principle of the Harriett decision, supra, relied on by the Circuit Court of Appeals for its allowance of this trust claim in the amount of $8,870.07 is erroneous because in clear conflict with the correct rule established by the weight of authority consisting of the decisions of this Honorable Court and the decisions of many Circuit Courts of Appeal.

VI.

ARGUMENT.

(A) Where, as in the instant case, and in the companion cases Nos. 338 and 340, set for argument immediately before this case, a claimant seeks to recover from a Receiver of an insolvent National bank money alleged to have been held by the bank on a trust he must affirmatively establish, under the unmistakable trend and weight of Federal decisions: (1) that his transaction with the bank resulted in a trust relationship; (2) that the assets of the bank have been augmented or increased by new cash or property accruing from the claimant; (3) that the new property, in its original or changed form, can be traced to the assets taken over by the Receiver at suspension. No augmentation occurs, hence no tracing exists where the transaction results only in a shifting of bookkeeping credits on the books of the now insolvent National bank.

In the instant case the now insolvent National bank received in trust an identifiable res in the form of the four items of collateral, consequently a trust relationship, at the outset, is admitted. The four collateral items were disposed of by the bank prior to its suspension. In exchange for the first three items the bank received nothing but transfers of credit already on its books which did not augment its assets and does not permit tracing of the proceeds to the Receiver. In exchange for the fourth item the bank received a check on an outside bank, which augmented its assets, but dissipated the proceeds thereof, prior to suspension, except as to the sum of $776.57 (admitted off the record, p. 18, ~~ante~~). The respondent can establish a trust relationship, augmentation and tracing of funds as to the sum of $776.57 only, which sum should be fixed as the amount of the priority claim rather than the sum of $8,870.07 erroneously fixed by the Circuit Court of Appeals.

The mandate of the National Bank Act requires a pro rata distribution of the assets of an insolvent National bank among all creditors. This mandate can be avoided by the respondent only upon affirmative proof of trust relationship, augmentation, and tracing of funds to the Receiver.

Section 5236 U. S. R. S. (12 U. S. C. Ch. 2, Sec. 194) (Appendix p. 33), requires a pro rata distribution of an insolvent National bank's assets among all its creditors. In referring to this section this court said in Cook County National Bank v. United States, 107 U. S. 445, 450, that it

> "*provides for the distribution of the entire assets of the bank,* giving no preference to any claim except for moneys to reimburse the United States for advances in redeeming the notes. When this reimbursement is fully provided for, the balance of the assets, as the proceeds are received, is subject to a ratable dividend on all claims proved to the satisfaction of the receiver, or adjudicated by a court of competent jurisdiction."

Even the United States as a sovereign is a general creditor only, unless it has taken the security provided by law, except for advances to redeem circulating notes and in minor instances involving certified checks given for customs duties and certain taxes. (19 U. S. C. Ch. 3, Sec. 198; 26 U. S. C. Ch. 3, Sec. 109). The circulating notes are required to be adequately secured at all times and the debtor continues to be primarily liable for the taxes and duties, consequently the exceptions are very rarely applicable.

The respondent and all others similarly situated can avoid participation in the pro rata distribution provided by the National Bank Act only upon a showing that the assets that passed into the hands of the Receiver for the benefit of all creditors included the property of the claimant or its proceeds. The respondent must show, *by the burden of proof,* that as a result of the transaction the bank, before suspension (a) received property of the claimant in trust, (b) that the property so received actually augmented the existing assets of the bank by way of add-

ing thereto cash or other property (as distinguished from the addition of a bookkeeping credit) and (c) that the augmented assets, in their original or changed form passed into the hands of the Receiver.

Unless the record contains affirmative proof by the respondent of trust relationship, augmentation and tracing of funds to the Receiver the trust claim fails because all doubts must be resolved in favor of the bank Receiver who is the trustee for general creditors. As stated by this court in Texas & Pacific Railway v. Pottorff, 291 U. S. 245, 261 (note 19), decided at the last term:

> "The claimant has the burden of identifying the property in its original or changed form. Schuyler v. Littlefield, 232 U. S. 707. It is not enough to show that at the time of receipt the general assets of the insolvent were increased or that debts were discharged. Wuerpel v. Trust Co., 238 Fed. 269, 272-3; Knauth v. Knight, 255 Fed. 677; State Bank of Winfield v. Alva Security Bank, 232 Fed. 847; In re See, 209 Fed. 172; In re Dorr, 196 Fed. 292; City Bank v. Blackmore, 75 Fed. 771; compare Railway v. Spiller, 274 U. S. 304, 311; Cunningham v. Brown, 265 U. S. 1."

In its opinion in Schuyler v. Littlefield, 232 U. S. 707, this court said, at page 713:

> "All these claims were disallowed because of the failure to make the requisite proof. Our investigation of the facts leads us to the same conclusion so far as concerns the appellants' claim. They were practically asserting title to $9600 said to have been traced into stock in the possession of the Trustee. Like all other persons similarly situated, they were under the burden of proving their title. If they were unable to carry the burden of identifying the fund as representing the proceeds of their Interborough stock their claim must fail. If their evidence left the matter of identification in doubt the doubt must be resolved in favor of the Trustee, who represents all of the creditors of Brown & Co., some of whom appear to have suffered in the same way. Like them, the appellants must be remitted to the general fund."

The following excerpt from the opinion of the Circuit Court of Appeals of the Eighth Circuit in Farmers National Bank v. Pribble, 15 Fed. (2nd) 175, 176 summarizes the principles of law applicable to these trust claims:

> "It is clear that counsel for the plaintiff were familiar with and probably had before them when they drew this complaint *the established rule in the federal courts* prescribing the facts requisite to establish a cause of action by a cestui que trust to recover from the receiver of the property of an insolvent corporation the payment in full of a trust fund in his possession in preference to the payment of anything to its general creditors, for they pleaded and set forth such facts in the complaint as stated a perfect cause of action in accordance with that rule, which is:
>
> 'It is indispensable to the maintenance by a cestui que trust of a claim to preferential payment (by a receiver) out of the proceeds of the estate of an insolvent that clear proof be made that the trust property or its proceeds went into a specific fund or into a specific identified piece of property which came to the hands of the receiver, and then the claim can be sustained to that fund or property only, and only to the extent that the trust property or its proceeds went into it. It is not sufficient to prove that the trust property or its proceeds went into the general assets of the insolvent estate and increased the amount and value thereof which came to the hands of the receiver.' Empire State Surety Co. v. Carroll County, 194 F. 593, 114 C. C. A. 435, and cases there cited; Beard v. Independent School District, 88 F. 375, 31 C. C. A. 562; In re Seven Corners Bank, 58 Minn. 5, 59 N. W. 633; American Can Co. v. Williams (C. C.), 176 F. 816; Willoughby v. Weinberger, 15 Okl. 226, 79 P. 777; Macy v. Roedenbeck, 227 F. 347, 356, 142 C. C. A. 42, L. R. A. 1916C, 12; Central Trust Co. v. Chicago, A. & N. Ry. Co. (D. C.), 232 F. 936, 943; State Bank v. Alva Security Bank, 232 F. 847, 849, 147 C. C. A. 41; Titlow v. McCormick, 236 F. 209, 149 C. C. A. 399; Zenor v. McFarlin, 238 F. 721, 725, 151 C. C. A. 571; Scullin Steel Co. v. North American Co., 255 F. 945, 947, 167 C. C. A.

237; Mechanics & Metals Nat. Bank v. Buchanan (C. C. A.), 12 F. (2nd) 891.

The doctrine that a cestui que trust, whose property had helped to swell the general assets of a corporation which was or became insolvent, has a prior right to or interest in those general assets, without specific identification and tracing of such claimant's property, was again expressly repudiated by this court in the case last cited. The fact that the claimant's property paid or reduced the indebtedness or liability of the insolvent corporation, so that it will pay a larger percentage of its debts, justifies no lien on its assets by or preference in payment to the cestui que trust (1) because such a reduction of indebtedness does not increase the property or the value of the property of the insolvent; and (2) because the property of the claimant so used to pay a part of the insolvent's general indebtedness or liability never goes into, and therefore cannot be traced into, the property or assets of the insolvent which subsequently come into the possession of the receiver. Titlow v. McCormick, 236 F. 209, 149 C. C. A. 399; American Can Co. v. Williams (C. C.), 176 F. 816; Lucas County v. Jamison (C. C.), 170 F. 338; Multnomah v. Oregon National Bank (C. C.), 61 F. 912; Beard v. Independent School District, 88 F. 375, 31 C. C. A. 562; Hecker-Jones-Jewell Mill Co. v. Cosmopolitan Trust Co., 242 Mass. 181, 136 N. E. 333, 24 A. L. R. 1148." (Italics inserted)

The record establishes that in exchange for the first three items of the bankrupt's collateral valued at $7,272.76, the bank received nothing but transfers of credits already on its books. That such bookkeeping transfers did not augment the bank's assets and do not permit tracing to the Receiver is well settled by a long line of Federal decisions. *The trust res ceased to exist as to these three items when they passed out of the bank's possession in exchange for bookkeeping credits* because "an obligor cannot be trustee either of his duties or of the obligee's right under the obligation." American Law Institute, Trusts Restatement Section 75, and comment "a" and illustration thereto. As

stated by this court in Blakey v. Brinson, 286 U. S. 254, 263, in discussing similar transfers of credit "the cancellation of the credit balance by the debit neither suggests any intention to establish a trust, *nor points to any identifiable thing which could be the subject of it.*" (Italics inserted) In the recent opinion of the Circuit Court of Appeals for the Fourth Circuit in Edisto National Bank v. W. Raymond Bryant, Executor, 72 Fed. (2) 917, the court said:

> "*Trusts are not declared in vacuo because of a trust relationship. They must be predicated of particular property.* Blakey v. Brinson, 286 U. S. 254, 263; Texas & Pac. R. Co. v. Pottorff, 291 U. S. 245, 261; Swan v. Children's Home Society of West Virginia (C. C. A. 4th), 67 Fed. (2nd) 84, 87; Gulley v. Wisdom (C. C. A. 5th), 69 Fed. (2d) 495. And the record before us shows no property as to which a trust could have been predicated. *The failure of the bank to segregate funds or set aside securities may have been a breach of legal duty on its part, but it certainly resulted in no identifiable res which could be declared the subject of a trust.*" (Italics inserted)

The following excerpts from opinions of Circuit Courts of Appeal in check collection cases are applicable to the first three items paid by transfers of credits:

> Larabee Flour Mills v. First National Bank of Henryetta (C. C. A. 8), 13 Fed. (2nd) 330; 331; cert. den. 273 U. S. 727:
>
> "*The real issue in each case is between the preference claimant and general creditors of the bank. They will get less if the preference is allowed.* Each claimant asserted an equity that the assets taken over by the Comptroller are trust funds in which it is a preferred beneficiary. *It is difficult to explain or understand by what equitable right one who has not contributed to the creation of a fund should be given a special and superior interest therein, though some of the state courts seem to so hold.* The collecting banks acted as agents, Commercial Bank v. Armstrong, 148 U. S. 50, 13 S. Ct.

533, 37 L. Ed. 363, and had they collected and retained the funds called for by the drafts, as was their duty on account of insolvency, the equities of claimants would be plain; but instead of doing so *they merely shifted credits on their books and records. No part of the funds in the banks when they failed was placed there by claimants or by any one for them. In each case the draft was paid by check on the insolvent. No additional funds were brought into the bank by either transaction.* If the drafts which they held for collection had been paid in currency or by check on some other bank, the insolvents' assets would have been increased that much when thereafter their remittance drafts were dishonored; and in that event equity would have regarded the collections as trust funds, followed them into the increased assets and, to the extent of the increase applied them first in discharge of these claims. *This is our conception of the rule and the reason for it, applied in the federal courts.* It has been repeatedly announced by this court." (Italics inserted)

Hirning v. Federal Reserve Bank of Minneapolis (C. C. A. 8th), 52 Fed. (2nd) 382, 386:

"It must be remembered that the checks sent to the Brookings Bank by the Reserve Bank were all of them checks drawn on the Brookings Bank. *When the Brookings Bank accepted the checks, this produced no additional funds in its hands. Its assets were not augmented. No trust fund was created. If there was no trust fund, there could, of course, be no tracing of the trust fund into any assets of the Brookings Bank.* The doctrine that a trust fund is created when checks drawn on bank A by bank B for collection, *i. e.*, for payment, has been disapproved by the decisions in this Circuit, *as has also the doctrine that the forwarding bank or its principal has a general lien on the assets of the drawee bank for the payment of such checks.* Rorebeck v. Benedict, etc. Co., 26 Fed. (2nd) 440; Farmers National Bank v. Pribble, 15 Fed. (2nd) 175; Larabee Flour Mills v. First Nat. Bank, 13 Fed. (2nd) 330; Macy v. Roedenbeck, 227 Fed. 346, 352; Beard v. Independent Dist., 88 Fed. 375." (Italics inserted)

Anheuser-Busch Brewing Association v. Clayton (C. C. A. 5th), 56 Fed. 759, 760:

"Accepting Morris' check in payment of his debt to appellant, and charging the amount of it on Morris' account by the bank, was but a shifting of its liability, whereby it became appellant's debtor, and assumed the obligation to pay to it the amount of the check less exchange. There is nothing to indicate that this amount was separated and kept unmingled with the bank's own money; but, on the contrary, it is conceded that it is undistinguishable from the mass of the bank's own money, and cannot be traced to and identified in the hands of the receiver. This being so, appellant has no better equity than the other creditors of the bank, and is entitled to no priority over them. It can only come in as a general creditor, * * *"

First National Bank of St. Petersburg v. City of Miami (C. C. A. 5), 69 Fed. (2nd) 346, 347:

"As proven, no sum whatever was collected and held for plaintiff by the St. Petersburg bank to which a trust could attach. In this state of the proof *to hold the bank as trustee would be to hold it a trustee not of a thing, but of a claim against itself, a holding on its face so artificial and unreal as to be impossible.*" (Italics inserted)

It thus appears that the claim of the bankruptcy trustee, based upon the first three items of the bankrupt's collateral, is general only, because the bank, prior to suspension, received in exchange therefor nothing but bookkeeping credits for which the bank Receiver has always been ready to account by accepting a general claim.

The record indicates that the respondent may contend that it has the right to look behind the credit balances the bank received in exchange for collateral items 1, 2 and 3 (bank stock, Graff note, and Sommer note) and claim as the proceeds of the trust property what the bank received to build up these credit balances. It is the position of the

bank Receiver that the respondent must look to these credit balances exclusively and that he is a stranger to the separate transactions between the bank and its customers which resulted in credit balances in favor of Cullinan, Graff and Sommer. The Cullinan credit balance was built up by a loan from the bank (R. 49) which brought no new money into the bank and the respondent is a stranger to the subsequent payment of the loan, based upon a separate contract between Cullinan and the bank. Even though the note was not collected the bank would be required to account. The Graff credit balance was built up from a deposit of checks totaling $14,013.64 on April 12, 1929. The proceeds of this deposit are traceable (1) into the First National Bank of Peoria, Illinois, low balance thereafter $51.41 (R. 50); (2) into the First National Bank of Chicago, low balance thereafter $70.54 (R. 51) and (3) into a bank subsequently merged with the Commercial National Bank & Trust Company of Peoria, low balance thereafter $351.94 (R. 52). The record contains no affirmative proof that the bank Receiver ultimately received anything from these correspondent banks, except that the low balance of $70.54, traceable into the First National Bank of Chicago, is included in the sum of $776.57 admittedly due the respondent as traceable funds under collateral item No. 4, which will be discussed later. The Sommer credit balance, charged April 16, 1929, *was built up on March 27, 1929* (R. 55) by a transfer of a credit balance already on the bank's books in the name of T. M. Smith. The Smith credit balance was built up (R. 55, 56) by a prior deposit of checks totaling $14,308.10. The proceeds are traceable into the low balances of $51.41 and $351.94 with the Peoria banks, already referred to under the Graff item. However, as the record does not contain affirmative proof that the bank Receiver ultimately received anything from these correspondent banks even though all of these facts were material, no affirmative tracing appears, hence the claim is general only under the rule applied by this court in Schuyler v. Littlefield, 232 U. S. 707, 713.

The rule applied by the Federal courts where a trust claimant seeks to look behind the credit balance is summarized in the following excerpt from the recent opinion of the court below in Allied Mills v. Horton, 65 Fed. (2nd) 708, 710:

> "The fact that a considerable part of the funds wherewith the drafts were paid was deposited in the bank on the very day the draft arrived and was paid, is not material. Had the funds been on deposit in Crisp's account for weeks or months the incongruity would not appear. *Whether the interval is a matter of minutes or of weeks, the fact is that the funds were on deposit in the bank when Crisp drew his check in payment of the draft and received the bill of lading, and the relation of debtor and creditor then actually existed between them.*
> Through the transaction the bank received nothing. Crisp's check depleted his own account in the bank, and the bank's liability for the same amount to the drawer of the draft at once attached. No cash came to the bank. Nothing was taken from or added to its assets. It is insisted that in any case the $105 of cash which Crisp deposited that day augmented the bank's assets by so much and should be held to constitute a trust. The instant this deposit was made the bank became debtor to Crisp and the deposit became part of the bank's general assets. The fact that Crisp intended to use it to take up these sight drafts is immaterial. *It may be presumed that one's checking account in a bank is intended sooner or later to be devoted to the uses of the depositor. This does not constitute such deposit a trust fund either for the benefit of the depositor or for such person or persons for whose use or benefit the depositor may intend to devote the account.*" (Italics inserted)

In Blakey v. Brinson, 286 U. S. 254, a bank depositor built up his credit balance for the special purpose of purchasing bonds. This court held that after such deposits, even for the purpose intended, the relationship between the

bank and the depositor was that of debtor and creditor, and denied the trust claim asserted. The same result was reached by the Circuit Court of Appeals for the Fifth Circuit in Larabee Flour Mills v. First National Bank of Dublin, 69 Fed. (2nd) 351, where the court said:

> "We notice only to reject a contention that Street & Co. on September 20 deposited in the Dublin bank checks drawn on other banks for the purpose of providing a special fund to meet its check given on that day to take up appellant's draft, because it appears that in making those deposits Street & Co. used the customary form of deposit slip, and, 'in accordance with its instructions, the deposit was credited by the bank in the usual manner.' After those deposits, 'as before, the bank remained a debtor' and Street & Co. 'a creditor for the amount of the credit balance.' Blakey v. Brinson, 286 U. S. 254, 52 S. Ct. 516, 517, 76 L. Ed. 1089, 82 A. L. R. 1288."

It thus appears that the respondent cannot look through the credit balances the bank received in exchange for the bank stock, Graff and Sommer items, hence that the facts concerning the building up of these credit balances are immaterial in determining the status of the respondent's claim.

For item 4 of the bankrupt's collateral, the 5 Veesaert mortgage bonds, the bank received a check in the amount of $1,597.31 drawn on an outside bank, the proceeds of which are traceable into its deposit balance with the First National Bank of Chicago as of December 13, 1930 (R. 58). The record, at page 58, evidences that the total credit balance of the now insolvent National Bank with the First National Bank of Chicago on October 27, 1931, was $643.24. The record does not contain affirmative proof that the now insolvent National bank's balance with the Chicago bank was at least $643.24 at all times between December 13, 1930, and October 27, 1931, and between October 27, 1931, and suspension on January 7, 1932. Consequently, if the

respondent is limited to the record, no part of these proceeds are traceable to the bank Receiver under the rule applied by this court in Schuyler v. Littlefield, 232 U. S. 707, 713, which classifies the entire trust claim of $8,870.07, as general only. However, since the decision of the court below in this case, the Comptroller of the Currency has obtained from the books of the First National Bank of Chicago, certified by it to be correct, a transcript of the account of the Farmers National Bank of Pekin, which evidences that the now insolvent National bank's balance with this Chicago bank was in excess of the sum of $1,597.31 at all times between December 13, 1930, and suspension except that the total balance on December 28, 1931, was $776.57.

The court below found (R. 84) that the least amount in cash and cash items on hand in the now insolvent National bank during the period from February 5, 1929, to the close of business on January 7, 1932, was $30,548.61. We know, however, from the record facts already discussed, that not one dollar of the proceeds of the four items of collateral are traceable into the cash or cash items on hand in the bank. Three of the items were exchanged for transfers of bookkeeping credits and the fourth for a check the proceeds of which were passed to the now insolvent National bank's credit in a Chicago bank. The collateral returned to the bank Receiver, after suspension was impressed with a trust in the amount of $776.57 in favor of the respondent but *no basis exists for the conclusion of the court below that any part of the proceeds of the bankrupt's collateral are traceable into the cash or cash items on hand in the bank at suspension.*

In the absence of a segregation, trust relationship as to the first three items of collateral failed when they were surrendered by the bank. As said by Mr. Justice Stone in an article entitled "Legal Problems in the Transmission of Funds", Columbia Law Review, June, 1921;

Page 518: "Even if there were an executory undertaking of the bank to become a fiduciary by setting apart such specific sum, such a relationship is not established until there is some actual setting apart or segregation of the money, or some other res as the subject matter of the fiduciary relationship."

Page 525: "The very essence of the right of priority over other creditors depends upon the setting apart of a particular fund for the benefit of the depositor. There is no basis for giving one depositor a priority over another unless this is an essential part of the transaction."

The difference between segregation and non-segregation is illustrated in St. Augustine Paint Company v. McNair (C. C. A. 5) 59 Fed. (2nd) 755, where the bank physically segregated a part of its cash to purchase the claimant's check held for collection. The court in its opinion at page 757 said:

> "*The conversion of the check into cash and segregation of such cash from the bank's general assets before using the check are of vital consequence, as those facts distinguish that transaction from those in which a bank of deposit merely credited a check to the depositor's account so as to become the depositor's debtor,* and thereafter used the check to pay the bank's own debts in such a manner that the proceeds were absorbed in a clearing transaction with no gain to the receiver, such as in Empire State Surety Co. v. Carroll Co. (C. C. A. 8) 194 Fed. 593, and other cases cited."
> (Italics inserted)

To summarize, the Farmers National Bank of Pekin received in trust four items of collateral, the property of John Fitzgerald, a bankrupt. Prior to its suspension the bank exchanged three of these items (bank stock, Graff note and Sommer note) for bookkeeping credits already on its books which classifies the bankruptcy trustee's claim as general only to this extent. In exchange for the fourth item

of collateral (the Veesaert mortgage bonds) the now insolvent National bank received a credit in the amount of $1597.31 in a correspondent bank. The record contains no affirmative proof that any part of this correspondent bank credit ever passed into the hands of the bank Receiver, consequently, on the record, the entire trust claim of $8870.07 is general only because of the failure to trace any proceeds into the hands of the bank Receiver. If the record can be read in the light of the supplemental information furnished herein by the Comptroller of the Currency, the respondent can trace the proceeds of item 4, the Veesaert mortgage bonds, to the extent of the sum of $776.57 only, the low balance in the First National Bank of Chicago as of December 28, 1931, which gives him the right to a trust claim in this amount, subject to possible prorating with other trust claimants similarly situated, and a general claim only for the balance.

(B) The tracing of funds principle of the Harriett decision, supra, relied on by the Circuit Court of Appeals for its allowance of this trust claim in the amount of $8870.07 is erroneous because in clear conflict with the correct rule established by the weight of authority consisting of the decisions of this Honorable Court and the decisions of many Circuit Courts of Appeal.

The tracing of funds theory of Schumacher v. Harriett, 52 Fed. (2nd) 817, accepted and applied by the court below in the instant case to allow the trust claim in full, is erroneous and is in conflict with the decisions of this court and many circuit courts of appeal.

In the instant case the court below made no attempt to specifically trace the proceeds of the four items of collateral into the hands of the bank Receiver but relied on the tracing fiction erroneously resorted to, we submit, by the Circuit Court of Appeals for the Fourth Circuit in Schumacher v. Harriett, 52 Fed. (2nd) 817. Consequently *the*

question in this connection presented in the instant case, is the soundness of the tracing of funds doctrine of the Harriett case. On this question the court below stated in its opinion (R. 85):

> *"It is further contended by appellant that the property in controversy has not been traced into his possession, which of course is necessary before appellee can recover.* In Schumacher v. Harriett, 52 Fed. (2nd) 817, it was disclosed that plaintiff had delivered life insurance checks to the bank to purchase bonds for plaintiff with the proceeds; that the checks were received by the bank as cash and treated by it as such, plaintiff receiving immediate credit therefor; that it forwarded the checks for credit to corresponding banks, in which on that day, and for several days thereafter, the sending bank had credit balances considerably in excess of the respective amounts so deposited. Those balances were gradually reduced until, *at the time of the depositing bank's failure, the account with one of the correspondent banks showed an overdraft, and the account with another bank showed a small balance which was credited upon a note which the correspondent bank held.* It was there said that the plaintiff, under those circumstances, had traced the trust fund in the bank receiver's hands." (Italics inserted)

The decisions of this court and the Circuit Courts of Appeal discussed under "A" above would necessarily, as a matter of principle, classify the trust claim asserted in the Harriett case as general only, because it clearly appears from the facts presented therein that the proceeds of the two checks received by the bank in trust, which augmented its assets, were completely dissipated by the bank prior to the time it passed into the hands of the Receiver. The decision in the Harriett case erroneously required the funds of the bank which belonged to the depositors to respond in full for the trust claim despite the fact that these funds were in no way enriched by the transaction. As hereinafter indicated (*infra* pp. ~~22-23~~ 26-28) this phase of the Harriett

decision has been repeatedly criticised and it stood alone in the Federal decisions until adopted by the court below in the instant case.

It is pure fiction to say, as was said by the courts below in the instant case and in Schumacher v. Harriett, that any part of the proceeds of the claimant's items, originally held by the banks in trust are traceable into the cash or cash items owned by the banks that passed into the hands of the Receiver. The tracing of the disposition of the items according to the record establishes, in each case, that not *one* dollar contained in the cash or cash items of the banks that passed to the Receiver was placed there by the trust claimants or any one on their behalf. The reasons why fiction should not be resorted to in establishing trust claims where the depositors of insolvent National banks are to be adversely affected are very well stated by the court below in its recent opinion in Connolly v. Lang, 68 Fed. (2d) 199, 202:

> "If this were a controversy only between appellee and the Bank there might be good reason for permitting fiction to pervert the facts because all the equities would be with appellee. This action, however, is really between appellee and the general depositors, who without fault on their part have been placed in positions which no doubt are equally deplorable and whose rights to have equity done are equally worthy of consideration."
>
> "From these facts and the further facts that the pass book was retained by the Bank and an entry made thereon showing that the entire amount had been drawn out and the ledger sheet pulled, appellee argues that it must be considered that she actually received possession of all the money and thereafter returned it to the bank officer, thereby augmenting the assets of the Bank. Of course, she never actually had the $8500 in her possession, and *we think we are not warranted in indulging in that fiction as between appellee and the other creditors.*" (Italics inserted)

In First National Bank of Ventura v. Williams, 15 Fed. (2nd) 585, 588, the Court said:

> "The answer to this is that courts must decide cases, not upon suppositions, but upon facts as proven or admitted, and the admitted fact is that cash was not received for the check, but that it was used merely to reduce the liabilities of the bank."

For expressions of opinions of other Appellate courts to the same effect we quote the following:

Wisdom v. Keen, (C. C. A. 5), 69 Fed. (2nd) 349, 350:

> "Equity if dealing with the bank alone might well consider that it had done what it should have done and might well hold it to the consequences. American National Bank v. Miller, 229 U. S. 517, 33 S. Ct. 883, 57 L. Ed. 1310. But in dealing with the distribution of the assets of an insolvent national bank and with the requirement of ratable dividends to all claimants a more stringent adherence to what was actually done is proper."

Beard v. Independent Dist. (C. C. A. 8), 88 Fed. 375, 381:

> "It is claimed in argument that the court must treat the case just as though the treasurer of the school district had presented the check, had obtained the money thereon, and had then deposited the money in the bank as the money of the school district, but this was not in fact done; and *as against the creditors, whose money in fact created the cash amount coming into the hands of the receiver, why should fiction be resorted to in order to sustain a preference on behalf of the school district to payment out of a fund not augmented in fact by any sum belonging to the district?*" (Italics inserted)

Smith v. Zemurray, (C. C. A. 5) 69 Fed. (2nd) 5, 6:

> "To the appellee's 'as if' argument, 'the matter is to be treated as though Robinson had presented the check to the teller and on receiving the money had paid it back over the counter to buy a draft,' American National Bank v. Miller, 229 U. S. 520, 33 S. Ct. 883, 57 L.

Ed. 1310, the receiver replies: 'Not so.' We know from Robinson's own testimony that this did not occur. *We know* from it that *what did occur* was an exchange of the paper of a bank, hopelessly insolvent, if plaintiff is right, in the form of an accepted draft on it, for paper of the same bank in the form of its draft on New York. This and nothing more.' He argues, too, that *when what actually occurred is known, it is idle to speculate on what might have been the legal effect of an entirely different occurrence.* Blakey v. Brinson, 286 U. S. 254, 52 S. Ct. 516, 76 L. Ed. 1089, 82 A. L. R. 1288." (Italics inserted)

Hecker-Jones-Jewell Milling Co. v. Cosmopolitan Trust Co. (Supreme Judicial Court of Mass.) (De Courcy, J.) 136 N. E. 333, 335:

"The other theory is that the transaction by which the draft was paid was in legal effect the same as if B. Greenglass & Son had drawn from their account through paying teller the sum of $3,518, in money, and then handed it back to the collecting teller in payment of the draft. But *that is not what the debtor did; and the difference is essential, not a mere matter of form. The payment made to the bank was not cash, to which the moment before it had not the slightest claim, and which therefore would count as wholly separate 'proceeds' of the collection; it was merely the lessening of one of its own debts, and productive of nothing even remotely suggesting a 'res' for a trust. The difference between the legal significance of the actual and the assumed courses of action cannot be ignored or confused.*" (Italics inserted)

People v. Merchants & Mechanics Bank, 78 N. Y. 269:

"The learned counsel contends that the Troy Bank was agent of the Chemical Bank to receive payment of the check. Suppose it were, *what did it receive as such payment? Simply its own obligation. If anything was set apart by charging up the check, it was only so much of the bank's indebtedness to its depositor.* * * * To make this case analogous it would be necessary to

show that the Troy Bank had separated from its general assets, and placed in the hands of some depositary, a sum sufficient to pay the check, for the express purpose of being so applied, and that this fund had come to the hands of the receiver in some form. There is no approach in this case to any such state of facts." (Italics inserted)

It should be noted that the case of Schumacher v. Harriett relied on by the court below for the allowance of this trust claim, was a companion case to that of Schumacher v. Brinson, 52 Fed. (2nd) 821. In both of these cases the court below relied on fictions to establish a trust against the assets of an insolvent National bank. Certiorari was applied for in the Brinson case only and the decision of the court below was unanimously reversed as Blakey v. Brinson, 286 U. S. 254. In disposing of the contention that a fiction contrary to the facts should be resorted to this court said, in its opinion at page 262:

"The court below thought that the legal consequence to be attributed to the debiting of the account with the supposed purchase price of the bonds was the same as if the respondent had cashed a check for the amount and had then proceeded to hand the money back to the bank under a specific agreement between him and the bank that the money was to be held as a special fund, for the sole purpose of completing the purchase. This view is not without support. (Citing authorities) *Such a procedure, if actually carried out, might afford a basis, which is lacking here, for the inference that respondent,* no longer content with the rule of creditor, *had sought to establish a trust fund. But the mere debiting of his account, without more, for the reimbursement of the bank for the obligation which it was supposed to have incurred or paid, lends no support to such an inference. The cancellation of the credit balance by the debit neither suggests any intention to establish a trust nor points to any identifiable thing which could be the subject of it.*" (Italics inserted)

Had the court below adhered, in the instant case, to the principles stated by it in denying similar trust claims in its recent opinions in Connolly v. Lang, 68 Fed. (2nd) 199, 202, and Allied Mills v. Horton, 65 Fed. (2nd) 708, 710, the Harriett tracing of funds fiction would have been rejected and the respondent's entire claim classified as general only.

The tracing of funds rule of the Harriett case is the basis of a number of actions now pending in the lower Federal courts to establish similar claims against Receivers of insolvent National banks. Some of these cases involve large amounts, two in excess of $300,000 each. If the Harriett tracing rule is sound outstanding trust claims based thereon will very substantially reduce the total dividends paid depositors of insolvent National banks.

The petitioner's contention concerning the unsoundness of the Harriett tracing of funds rule are summarized in the following excerpts from recent opinions of the United States Circuit Court of Appeals for the Fifth Circuit.

Pottorff v. Key, 67 Fed. (2nd) 833, 834:

> "Schumacher v. Harriett (C. C. A.), 52 Fed. (2nd) 817, 82 A. L. R. 1, is much relied on to sustain the judgment appealed from. The court there reviews the cases and concedes that they establish such principles as we have just asserted, but avoids their consequences by *the novel view* that a trust check, when treated by a bank as one of its cash items, is thereby confused with its cash as though it had been unidentifiable currency; and that, if the bank misuses the check, it thereby sets apart as a trust res an equivalent value of other cash assets. *Such a doctrine amounts to saying that in every case of misapplied money or money's equivalent the wrongdoer's other cash and cash items stand in its place so long as he has any, establishing in effect a general lien on all such. 'If the plaintiff's contention be well founded, and to follow misappropriated moneys it is only necessary to show that a receiver has, and that the trustee had, assets, the rule is simply that a demand for such moneys is a preferred claim against any substantial estate. To adopt this view is to do away with*

all the equitable principles out of which the right to follow trust funds grew.' American Can Co. v. Williams (C. C. A.), 178 F. 420, at page 423. *We hold in this connection that, if a trust res can be followed, it must be; and that a lien by confusion can be fixed on a fund only when the confusion is actual and when the fund is shown to have really received and to still contain the trust res or its proceeds.* The judgment is reversed, with direction to disallow appellee's claim as preferred and to allow it as a general claim only." (Italics inserted)

Wisdom v. Keen, 69 Fed. (2nd) 349, 350:

"The view that when a bank becomes obligated to collect for another person checks drawn on itself and makes entries of their collection, it must in equity be considered to have done what it should have done, to wit, to have collected them in cash though afterwards commingling the customer's cash thus collected with its own, so that a traceable res is brought into being with title vested in the customer, has been adopted by a growing number of state courts and is said to be the majority view in an elaborate examination of the cases in 82 A. L. R., page 97. *It was pressed to its furthest extent in the Fourth Circuit in Schumacher v. Harriett,* 52 Fed. (2nd) 817, 82 A. L. R. 1, and *Schumacher v. Brinson,* 52 Fed. (2nd) 821. *Otherwise the federal cases have been to the contrary.* 82 A. L. R. 101. Schumacher v. Brinson was appealed and reversed as Blakey v. Brinson, 286, U. S. 254, 52 S. Ct. 516, 76 L. Ed. 1089, 82 A. L. R. 1288. *We refused to follow Schumacher v. Harriett in Pottorff v. Key* (C. C. A.), 67 Fed. (2nd) 833. At the conclusion of the opinion in *Texas & Pacific R. Co. v. Pottorff,* 54 S. Ct. 416, 78 L. Ed. ——, *the Supreme Court again indicates the necessity of an identifiable trust res in order to create a trust by misconduct as distinguished from a general liability in contract or tort. Whether the question be one of general equity jurisprudence or of the application of the federal law relating to insolvent national banks, the views of the federal courts must in such courts be controlling."* (Italics inserted)

The same criticism of the Harriett opinion is made in 80 Pennsylvania Law Review 587.

Since its decision in Schumacher v. Harriett, 52 Fed. (2nd) 817, the Circuit Court of Appeals for the Fourth Circuit has not allowed a trust claim against the Receiver of an insolvent National bank except where the record contained affirmative proof of the three essentials of trust relationship, augmentation and specific tracing of the proceeds to the Receiver. The petitioner submits that since the decision of this Court in Blakey vs. Brinson, 286 U. S. 254, the recent well considered opinions of the Circuit Court of Appeals for the Fourth Circuit in this class of cases indicate its departure from the position taken in Schumaker vs. Harriett and to some extent in Ellerbe vs. Studebaker Corp., 21 F. (2) 993, and a return to or adoption of a position of strict adherence to the settled Federal rule requiring *actual* augmentation and tracing rather than fictions. We refer in this respect to the recent opinions of the Circuit Court of Appeals for the Fourth Circuit in Harmer v. Rendleman, 64 Fed. (2nd) 422; Swan v. Childrens Home Society, 67 Fed. (2nd) 84, certiorari denied 290 U. S. 704; Santee Timber Corp. v. Elliott, 70 Fed. (2nd) 179; Edisto National Bank of Orangeburg v. W. Raymond Bryant, Executor, 72 Fed. (2) 917, and Spradlin Receiver v. Royal Mfg. Co., as yet unreported, decided November 19, 1934. The petitioner believes that these latter opinions indicate that the Harriett claim would be classified as general only if represented to the Circuit Court of Appeals for the Fourth Circuit today.

The bank Receiver assumes that this court's action in granting a review disposes of the contention set out in the respondent's brief in opposition to the petition for writ of certiorari to the effect that this court will not review findings of fact in which both courts below concur. It is settled that this court will review findings of fact concurred in by the two lower courts when shown to be clearly against the

evidence or induced by an erroneous view of the law. Bodkin v. Edwards, 255 U. S. 221, 223; Texas & New Orleans Railroad Company v. Railway Clerks, 281 U. S. 548, 558. Applying the rule to the instant case it appears that the record before this court contains all the evidence that was before the courts below, the facts having been stipulated. The trial court found as a fact (R. 67) that the four items of the bankrupt's collateral "were converted into cash and used by the Receiver's bank as its own." This finding was clearly erroneous because the record establishes beyond any question that three of the four items of collateral were not converted into cash by the bank but were exchanged for transfers of bookkeeping credits. The trial court found that the proceeds of the four collateral items were traced into the cash and the cash items on hand in the bank at suspension. This was clearly erroneous because we know from the record, as already discussed, that not one dollar contained in the cash and cash items came from the four items of collateral. The bank Receiver denies that the trial court's findings of fact were concurred in by the Appellate court. On the contrary the Appellate court disagreed with the trial court's findings of fact when it held that the four items of collateral were not converted into cash in this language of its opinion (R. 85). "It is next contended by the appellant that the bank's assets were not augmented by the amounts received by it in payment of the obligations of the collateral. *This is no doubt true,* * * *" The Appellate court did not find, as a matter of fact, as was found by the District court, that any of the proceeds of the four items of collateral had been traced, *under the record,* to the Receiver. The Appellate court's conclusion is based upon a legal fiction as evidenced by the language in the opinion (R. 87): "We are convinced that the bank's assets were augmented by, and to the extent of, the proceeds of the collateral, and that those proceeds have in law been traced into the Receiver's hands." The bank Receiver submits

that this case does not present findings of fact concurred in by the two lower courts; that the case does present findings of fact by the trial court shown to be clearly erroneous by the stipulation of all facts contained in the record before this court, and that the clearly erroneous findings of fact and conclusions of law of both courts below should be reviewed as was done in the similar case of Blakey v. Brinson, 286 U. S. 254.

The National Banking Laws and related acts, together with a long line of decisions by this Court clearly evidence an intent to safeguard the assets of insolvent National banks in liquidation, thus insuring a maximum distribution to the depositors and creditors. Taxes due the United States which would be paid from the funds of depositors are abated. (Sec. 570, Title 12 U. S. C. A.) The preference given the United States as a sovereign against insolvent estates generally is inapplicable to such banks. Suits to wind up the affairs of such banks are made cognizable in the Federal courts, *independent of the amount involved.* A separate system of liquidation is provided, independent of the Bankruptcy Act. Sales and compromises of assets can be made only after court approval and advances to protect assets can be made only upon approval by the Secretary of the Treasury. Annual reports of the results of liquidation are required to be made to Congress. While the claimants in the instant case and in the companion cases Nos. 338 and 340 assert ownership of property taken over by the Receivers they are in fact, as established by the record, seeking to be made whole from the funds of the depositors. To permit any class of claimants to be paid in full from the funds of depositors, when such funds were in no way enriched by the claimants' transactions, would flagrantly violate the principles heretofore adhered to in liquidating insolvent National banks.

The depositors and other creditors of this insolvent National bank—the beneficial owners of its assets—will suffer a substantial loss because of their dealings with the bank.

Their equities are at least equal to those of the respondent. The four items of the bankrupt's collateral upon which this trust claim is based, were disposed of by the bank prior to suspension. The record establishes beyond any question the identity of the proceeds received by the bank. In exchange for the first three items the bank received nothing but pre-existing credit balances on its books which definitely defeats all prospect of tracing funds to the Receiver. The record does not contain affirmative proof that any part of the proceeds of the fourth item is traceable into the hands of the bank Receiver, consequently the entire claim is general only, under the record. If the additional information supplied by the Comptroller of the Currency can be considered the respondent should be allowed a priority claim in the amount of $776.57, subject to a possible pro rating with any other trust claimants similarly situated and a general claim only for the balance. This sum of $776.57 represents that part of the proceeds of the fourth item of collateral, traceable to the First National Bank of Chicago, that was not dissipated through use by the now insolvent National bank in payment of its debts prior to suspension.

VII.

CONCLUSION.

It is believed that the foregoing discussion establishes that the record shows that the cash and cash items of this insolvent National bank are not impressed with a trust in favor of the respondent, in any amount, as held by the court below; that all four of the bankrupt's items, held in trust by the bank, were disposed of by it prior to suspension; that in exchange for three of the items the bank received nothing but pre-existing credit balances on its books which result, to this extent, in a general claim only; that in exchange for the fourth item the bank received a check on an outside bank, the proceeds of which are not affirmatively traced, of record, to the bank Receiver, and consequently,

based on the record, the respondent's entire claim is general only. If the additional information furnished herein by the Comptroller can be considered by this court, the respondent should be allowed a priority claim in the amount of $776.57, which, as a matter of fact, represents the only proceeds of the bankrupt's collateral that passed into the hands of the bank Receiver after suspension. If a priority or preferred claim in the sum of $776.57 is allowed, we consider that the final decree in the case should direct the bank Receiver to certify any claim allowed, to the Comptroller of the Currency for payment in due course of administration, thus insuring that the rights of any other claimants similarly situated, who may have proved their claims to the satisfaction of the Comptroller as provided by Section 194, Title 12, U. S. C. A., will be protected.

It is submitted that the decision of the court below should be reversed.

Respectfully submitted,

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APPENDIX.

U. S. C. A. Title 12, Section 194:

DIVIDENDS ON ADJUSTED CLAIMS; DISTRIBUTION OF ASSETS. From time to time, after full provision has been first made for refunding to the United States any deficiency in redeeming the notes of such association, the Comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, shall be paid over to the shareholders of such association, or their legal representatives in proportion to the stock by them respectively held. (R. S. 5236.)